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IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1942

3170 S. #1
ABR-AME

LOUIS ABRAHAM, ET AL
TRUSTEES OF THE
JOE ABRAHAM ESTATE PETITIONERS

VS.

HIDALGO COUNTY WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1, ET AL
RESPONDENTS

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## REPLY BRIEF OF THE RESPONDENTS, TEXAS AGRICULTURAL ASSOCIATION OF EDINBURG, TEXAS, ET AL.

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## REPLY BRIEF OF THE RESPONDENTS, TEXAS AGRICULTURAL ASSOCIATION OF EDINBURG, TEXAS, ET ALS.

---

TO THE HONORABLE SUPREME COURT
OF THE UNITED STATES

## REPLY TO PETITION FOR WRIT OF CERTOIRARI

To the Supreme Court of the United States:

Respondents the Texas Agrciultural Association of Edinburg, Texas, composed of resident property taxpayers in the respondent district file this their reply to the petition for a writ of certoirari.

The petitioners will be referred to as such or as the Abrahams; the respondent Hidalgo Water Control & Improvement District No. 1 as the district; The Reconstruction Finance Corporation as the R. F. C. and the Texas Agricultural Association of Edinburg, Texas, et als, as respondents or as taxpayers.

## STATEMENT OF THE CASE

The Circuit Court of Appeals has made such a clear, full and accurate statement of the case, that such statement is adopted. (R-358-62).

## INACCURACIES OF PETITIONERS STATEMENT

(1) At paragraph 2, page 5, of the petition it is contended in effect that the delinquent tax account was set up to take care of non-consenting creditors. The Record shows that the R. F. C. required the reduction of delinquent taxes. That a plan to reduce the same 75 per cent was adopted and a Trustee was appointed to carry out the plan. The R.F.C. furnished the Trustee matured coupons, the taxpayer paid 25 per cent to the Trustee for the coupons, creating the trust fund, or delinquent tax

fund. (R.262-263). The law authorizing the R. F. C. to make refinancing loans required such reduction. Subsection (5), Section (403) Title (43), U. S. C. A.

(2) At paragraph 3, page 5, petitioners state that the bonds belonging to the Abraham Estate were of much greater market value than the other bond issues of the District This is wholly unsupported by the Record. The only testimony in the Record as to market value of any of the bonds, was that of Manager Joe Burns, that in 1933 to 1934, prior to the Refunding Plan, the bonds of the District were selling in the market from 17 to 25. (R.257-258).

(3) At page 7, lines 8 to 12, petitioners contend that either the 45.895 or the note sued upon, was to be paid out of the delinquent tax trust fund and cites (R-251). The Record cited shows that there was no money in this fund to pay the Abraham Estate. Both the Record and the stipulation therein show that the 45.895 paid to the Abraham's for their bonds came from the RF.C. (R.361)

(4) The petitioners contend at pages 7-8, that the Abraham's did not know that the money was coming from the R. F. C. upon the bonds to pay the 45.895. The Record shows, and the Circuit Court of Appeals found (R-361 lines 28 to 34):

> "Evidence in the record compels the conclusion that the Trustees were fully informed of the provisions of the agreement between the District and the R. F. C. for the loan and knew that the District had no other source from

which to pay the cash amount of the settlement except by borrowing the money from the R. F. C., which required the deposit of the original bonds."

(5) At several places in their opening statements (pp 3 to 11) petitioners refer to the transaction out of which the note arose and the note declared upon as a "refunding" of their $32,000.00 in bonds formerly owned by them but now owned by the R. F. C. This assertion is inaccurate as a statement of fact, and erroneous as a conclusion of law, which we will demonstrate fully.

## REPLY TO THE QUESTIONS PRESENTED IN THE PETITION FOR CERTOIRARI

### I.

### REPLY TO FIRST QUESTION

### POINT A.

This question assumes that the void note is a valid "refunding" of the bonds formerly owned by the Abrahams but now owned by the R. F. C.; while the Texas law requires: That new bonds be issued; approved by the Attorney General or validated by a judgment of the District Court, and the new bonds be registered by the Comptroller when the old bonds have been presented to the Comptroller and cancelled.

### STATEMENT

The original bonds held by the Abrahams were issued in conformity with law and registered with the Comptroller of Texas, and were binding obligations of the district. These bonds are still out-

standing, unpaid and in the hands of the R. F. C. The note upon which the judgment of the trial court was based finds its sole support in the resolution of July 30, 1937. The note was not approved by the Attorney General or registered with the Comptroller. It does not purport to be a bond. The original bonds were not cancelled; neither were they presented to th Comptroller for cancellation. The note was not validated by a judgment of the District Court.

## ARGUMENT OF AUTHORITIES

This district operates under Chapter 3-A of Title 128 of the Texas statutes. It is Article 7880-Sections 1 to 147 (z) of Vernon's Civil Statutes of Texas.

Section 92 thereof provides that such districts may refund their bonds by issuing new bonds for that purpose. That the Comptroller shall not register the new bonds until the old bonds are presented for payment or exchange and cancelled.

Section 34 provides that bonds may not be issued until all proceedings incident to the issuance of bonds by such districts are presented to the Attorney General that approved by him and his certificate obtained that they are valid obligations of such district, which certificate shall be filed with the Comptroller.

Sections 95 to 100 provide an alternate method of validation by judgment of the District Court of certain Counties to which suit the Attorney General is a party.

Section 86 provides that bonds of such districts

shall be in denominations of not less than one hundred dollars ($100.00), nor more than one thousand dollars ($1,000.00).

Manifestly the void note does not meet any of these requirments for valid refunding bonds. It would follow therefore that the note is void because issued without authority of law.

POINT B.

The note was void because it was not authorized or adopted by the qualified property tax-paying voters of the district.

Section 59 (C) of Article XVI, of the Constitution of Texas provides:

> "(a) The Legislature shall authorize all such indebtedness as may be necessary to provide all improvements and the maintenance thereof requisite to the achievement of the purpose of this amendment, (b) and all such indebtedness may be evidenced by bonds of such conservation and reclamation districts, to be issued under such regulations as may be prescribed by law, (c) and shall also authorize the levy and collection within such districts of all such taxes, equitably distributed as may be necessary for the payment of the interest and the creation of a sinking fund for the payment of such bonds; (d) and also for the maintenance of such districts and improvements, (e) and such indebtedness shall be a lien upon the property assessed for the payment thereof; (f) *provided the Legislature shall not authorize the issuance of*

*any bonds or provide for any indebtedness against any reclamation district unless such proposition shall first be submitted to the qualified property tax-paying voters of such district and the proposition adopted.* (Section 59, Art. XVI, adopted election Aug. 21, 1917; proclamation October 2, 1917.)" (Parenthetical letters ours).

POINT C.

The note attempts to create a debt without a vote of the people of the District.

Article XVI, Sec. 59 Constitution of Texas.

Brown County Water Improvements District No. 1, vs. Austin Mill and Grain Co. 136 Texas 140, 138 S. W. (2) 523.

Cameron County Water Improvement District No. 8 vs. De La Vergne Engine Co. 93 Fed. (2) 373.

In Brown County W. D. D. No. 1 vs. Austin Mill & Grain Co. 138 S. W. (2) 523 the Supreme Court of Texas held at page 525 (1) that the above constitutional prohibition against the creation of "indebtedness" without a vote of the people, includes all enforceable obligations which may be incurred regardless of the conditions of their payment or the time in which they may be payable. (2) That "indebtedness" includes all obligations which are payable from taxes that are a lien upon the land.

In holding the Abraham note void the Fifth Circuit Court of Appeals was following the rule definitely announced by the Supreme Court of

Texas in the above case construing the local law. It followed the rule heretofore announced by the Fifth Circuit in Cameron W. D. D. No. 8 vs. De La Vergne in a case involving a similar state of facts. (93 Fed. (2) 373).

POINT D.

The Circuit Court of Appeals and this Court are bound by the decision of the Supreme Court of Texas construing the State Constitution, since no federal question is involved.

Erie Ry. Co. vs. Tompkins, 304 U. S. 64, 82 L Ed. 1118.

POINT E.

Alleged conflict of the decision in this case with the decisions of other Circuit Courts of Appeals and of this Court concerning suits upon municipal securities arising in other States is wholly immaterial since this suit involves the construction of the Texas constitution.

Erie Ry. Co. vs. Tompkins, 304 U. S. 64, 82 L Ed. 1118.

POINT F.

The decision in this case is not in conflict with the decision of the Supreme Court of Texas in Dallas County vs. Lockhart 96 SW (2) 60, and Tyler vs. Jester 78 SW 1058, because those cases are not in point.

(1) Those cases involved two entirely different sections of the Constitution of Texas.

(2) In those cases there was specific statutory authority to issue the refunding securities and the

statutes had been fully complied with in each case.

(3) Those cases involved refunding bonds issued pursuant to law while this case involves a note issued without authority of law.

(4) The old securities in those cases were presented to the Comptroller and canceled before the refunding securities were issued, while in this case the Abrahams' bonds are in the hands of the Reconstruction Finance Corporation, a holder in due course. (R. 166 & 203).

II.

## REPLY TO SECOND QUESTION PRESENTED IN THE PETITION.

Point A. There is no equity in the claim of the Abrahams that would warrant a departure from the settled rule of law in Texas.

The Circuit Court of Appeals found and the evidence amply supports the finding: (R-361-362).

> "Evidence in the record compels the conclusion that the Trustees were fully informed of the provisions of the agreement between the District and the R. F. C. for the loan and knew that the District had no other source from which to pay the cash amount of the settlement except by borrowing the money from the R. F. C., which required the deposit of the original bonds." * * *
>
> "It is plain that unless the loan agreement with (fol. 363) the R. F. C. was consummated the old bonds were practically valuless."
>
> "It is plain the Trustees endeavored to com-

pel payment of their debt in full by refusing to consent to the reorganization agreement for the purpose of securing a preference over a large majority of other creditors of the same class. The Trustees obtained their share of the loan in cash and endeavored to bind the District to pay the debt in full through the execution of the note in suit."

ARGUMENT

The Abrahams received from the R. F. C. 45.895 in cash, the same amount received by the holders of over 95 per cent of the district's bonds. One of the cardinal principles of equity jurisprudence is: that equality is equity.

Moreover the Abrahams received all their bonds were worth and more than their market value and the Circuit Court of Appeals found that the district's bonds were practically valueless except for the refunding plan. The only testimony in the record as to market value is that of former manager of the District Joe Burns to the effect that the district's bonds were offered in the market in 1933 and 1934 prior to the refunding plan at from 17 to 25 cents on the dollar.

Manifestly the Circuit Court of Appeals was justified in holding (1) there was no equtiy in the claim of the Abrahams that would warrant a departure from the settled rule of law in Texas (2) and that in bankruptcy, (a proceeding governed by the principles of equity. American United Mutual Life Insurance Co. vs. Avon Park, 311 U. S. 138, 61 Sup. Ct. 157, 85 L Ed. 91 at 95) the Abrahams

will be entitled to receive the amount they have received in cash and no more. Texas Agricultural Association et als, vs. Hidalgo W. C. & I. D. No. 1 vs. Abraham et al, 125 Fed. (2) 829 at 832 (8) (10).

## REPLY TO QUESTION III.

Point A. The Abrahams are not entitled to the relief by way of mandamus provided in Art. 7880-136, R. C. S. of Texas.

(1) Because they have no judgment for debt against the district rendered by any Court within the State of Texas, required by the above statute.

(2) Because the bonds formerly owned by the Abrahams; the debt evidenced thereby; and the rights incident thereto, are owned by the R. F. C., a holder in due course.

(3) Because the Abrahams have received in cash the full value of their bonds from the R. F. C.

(4) Because it would give the Abrahams a preference of $29,982.53 ($44,669.03 - $14,686.40) on $32,000 par value of bonds over other creditors of an insolvent irrigation district or over 204 per cent!

---

## PAYMENT OF JUDGMENT AGAINST DISTRICT

"1 In the event that any court within the State shall render any judgment of debt against any district such court may order the directors of such district to levy, assess and collect taxes or assessments to provide for the payment thereof. (Acts 1925, 39th Leg., ch. 25, p. 131, 136)."

(5) Because the district has a bankruptcy case pending under chapter 9 of the Bankruptcy Act to compel the same minority, owning claims of the same class; namely: payable from taxation, to accept the plan. Such mandamus would interfere with the jurisdiction of a Court of Superior jurisdiction and would give an inequitable preference to one creditor of 204 per cent.

(6) All the funds mentioned in this question had been previously pledged to the payment of the R.F.C. loan as shown by its resolution (Ex. A.R. 123) and the acceptance thereof (Ex. B. R. 142) and as found by the Circuit Court of Appeals, (R. 362). Consequently the Abrahams have shown no fund out of which they are entitled to be paid. The Supreme Court of Texas has repeatedly held this showing indispensible to the granting of mandamus. Craven vs. Coleman, 100 Tex. 467,101 SW 199; Matthei vs. Clark, 110 Tex. 114, 216 SW 856.

## REPLY TO REASON A-4, PAGE 16 OF THE PETITION

The Abrahams at page 16 of their petition under the heading: "Reasons for granting the writ," as their fourth (4) reason under the first question presented assert:

> "The decision of the Honorable Circuit Court of Appeals is an important one and of far-reaching consequences to the State of Texas, in that it involves potentially millions of municipal bonds and notes issued for the purpose of refunding and refinancing valid indebtedness

of municipalities of this State, many of which refunding bonds and notes are held by the R. F. C. and P. W. A."

This proposition is neither sustained by the record, nor by the petition and brief in support thereof. It is a puerile effort to stampede this Court into granting a writ upon the bold assertion of grave consequences to governmental agencies. It is significant to note that the R. F. C., the owner and holder of over ninety-eight per cent (98 per cent) of the District's bonded and funded indebtedness, as well as the owner and holder of all the refunding bonds issued by Irrigation Districts in Texas pursuant to the refinancing power granted by Section 406, Title 430 U. S. C. A., and the owner of most of the bonds of Irrigation Districts in Texas purcahsed by the P. W. A., and fully aware of this proceeding, has not intervened herein to avoid the awful consequences asserted by the Abrahams. As a matter of fact, petitioners counsel knows well that the R. F. C. is entirely in sympathy with the position of these taxpayers, as well as the District.

Just what did the Circuit Court of Appeals hold that was of such grave consequences? It simply held that since the note held by the petitioners was not authorized by a vote of the people as required by Section 59, Article 16 of the Constitution of Texas, under which the District was created, that the note was void. This holding simply follows the well established rule of law in Texas, Brown County Water Improvement District No. 1 vs. Austin Mill and

Grain Company 138 SW (2) 523.

Petitioners are reminded that this is a tax-payers suit in equity to cancel a note, which if valid would constitute an unconscionable preference in favor of one group of creditors of an insolvent Irrigation District, and to injoin that Distrct from levying, or collecting a tax upon their property to pay said note. Petitioners are also further reminded that this constitutional limitation was placed in the organic law of Texas for their protection, and all persons dealing with the officials of such Districts, or seeking to take advantage of them, are charged with notice of such constitutional limitation as well as the interpretation and application thereof by the Supreme Court of Texas.

REPLY TO REASON NO 5 FOR GRANTING THE WRIT SET OUT UNDER QUESTION (A) AT PAGE 17 OF THE PETITION.

THE NOTE INVOLVED IN THIS CASE IS NOT AUTHORIZED BY ARTICLE 7880-147 (U) OF THE REVISED CIVIL STATUTES OF TEXAS.

This proposition was first asserted by the trial Court in support of his judgment. It was briefed by both parties in the Circuit Court of Appeals. These respondents briefed it under point VII, at pages 71 to 84 of their brief. The Circuit Court of Appeals did not pass expressly upon this question for the obvious reason that it was not necessary because the note was void upon constitutional grounds and the statute, if applicable, could not grant powers prohibited by the constitution.

It is well to keep in mind that the power to issue

refunding bonds does not exist in the absence of statutory authority. McQuillan Municipal Corporations, 2nd Edition, Revised Volume 6, page 165 states the rule as follows:

> "The general rule is that there is no inherent power to issue renewal of refunding bonds, and hence statutory or charter authority must be conferred. Thus, the mere existence of muncipal indebtedness is not authority therefor, and the power to issue the original bonds does not include power to issue new bonds to take their place. So power to borrow money does not, of itself, confer power to issue refunding bonds."

Section 4 of Article 7880-147 (u), relied upon by the Abrahams provides:

> "If the government of the United States or a lending agency thereof, as a condition precedent to leding money to or purchasing bonds of any district under the provisions hereof, shall require such districts to retire its existing bonded indebtedness or to subordinate its existing bonded indebtedness in such manner that the loan made or the bonds purchased by the Government or such lending agency shall have a claim on the proceeds of all taxes collected by said district prior and superior to the claim of all or part of such existing bonded indebtedness, said district is hereby empowered to enter into such agreement or agreements with the government or lending agency thereof and with

the holder or holders of such existing indebtedness as may be necessary or appropriate to accomplish such purpose. Such agreement may provide for the deposit or escrow of the bonds so subordinated with a trustee, or may provide for stamping on such subordinated bonds and coupons an appropriate legend, or may provide for the replacement of such subordinated bonds with refunding bonds containing recitals appropriate to such subordination, and *if refunding bonds are so issued* such bonds may be issued without an election, and need not correspond as to interest rate, maturity and other details with the bonds refunded.

"If the holder or holders of part of such existing bonded indebtedness of said districts are unwilling to enter into an agreement of the nature hereinabove outlined, but are willing to enter into an agreement with said district under the terms of which all or part of the uncollected taxes theretofore levied by said district for the payment of all or part of the outstanding bonded indebtedness of said district shall, when collected, be paid into a special interest and sinking fund created for the sole purpose of *paying interest on and principal of the bonds held by such holder or holders,* said district is hereby empowered to enter into such agreement. If such agreement is made no moratorium or tax payment extention law and no statute of limitation now or hereafter applicable

to the payment of taxes shall ever apply to the collection of the taxes so provided to be paid into such special interest and sinking fund."

The historical note after this article in Vernon's Texas Civil Statutes, Volume 21, page 373, states the following:

"Acts 1936, 44th Leg., 3rd C. S., p. 2092, ch. 501, Sec. I, amended section act of 1936, article. Prior to the amendatory act of 1936, section one of this article applied to "Any water control and improvement district in this State, embracing lands in two or more counties, and containing not less than 125,000 acres."

It is submitted that the above statute has no application and does not sustain the trial court or the validity of this note for the following reasons:

(1) Because the statute was not enacted until 1936, and the original bonds were authorized and issued in 1923, and it would be giving the statute retroactive effect if it were applicable. State ex rel Abney vs. Miller, 128 SW (2) 1134 at page 1136 states:

"But we do not hold that the interim bonds under attack were validly issued. The election by which the district authorized the issuance of $5,500,000.00 of construction bonds was held on March 14, 1930. At that time the statute Article 7880-84a, Acts 1929, 1st Called Sess., C. 82, sec. 1, authorized the issuance of interim bonds in an amount not to exceed ten per cent of the principal amount of the

unsold construction bonds. The statute further provided that such interim bonds should mature not later than five years from the date of their issue. As above stated, the voters at that election authorized the issuance of interim bonds in the amount and upon the terms provided by that statute. They did not authorize the issuance of such bonds in any greater amount than, or upon any terms different from those provided therein. After the election authorizing the issuance of construction and interim bonds, an amendment of Article 7880-84a of Vernon's Statutes became effective authorizing interim bonds in an amount not to exceed 25 per cent of the principal amount of the unsold construction bonds, and providing that such bonds should mature not later than ten years from the date of their issue. The amendment became effective April 9, 1930. Acts 41st Legislature, Fifth Called Session, ch. 31, p. 163. The bonds here involved were issued the day after the amendment became effective. According to the allegations, they were issued to an amount of more than twenty per cent of the principal amount of the construction bonds and matured ten years from the date of their issuance. Such bonds were not authorized by the voters.

We do not hold that Article 7880-84a, as amended, authorizing the issuance of ten year interim bonds to an amount of 25 per cent of

the construction bonds, is unconstitutional. That question is not involved. *What we hold is that the amendment may not be given retroactive effect, but applicable only to bonds voted after its effective date. The validity of interim bonds, as of all other bonds must be tested by the law as it existed when their issuance was authorized. While interim bonds do not operate to create an additional indebtedness against the district, they are nevertheless bonds of the district and can be issued only in accordance with the statutes as they existed when they were authorized.* (Italics ours).

These cases are clearly analogous, involving a district created under the same statutory and constitutional provisions. Moreover, the interim bonds involved in that case were not the bonds authorized at the election even as the note in this case was not authorized at an election. Both are dependent upon statutory authority. Judge Hickman, speaking for the Supreme Court of Texas, states that the statute may not be given retroactive effect, but is applicable only to bonds voted after its effective date. The distinguished counsel for the Abrahams were of counsel for the prevailing parties in the above case and helped to establish this salutary rule. They are bound by it as well as this Court.

(2) The statute clearly contemplates one of two things as a condition precedent to the Government lending money to or purchasing bonds of any

district under the provisions hereof: (a) The first is to retire its existing bonded ndebtedness. Clearly this was not done. (b) The other is to subordinate its existing bonded indebtedness to the claims of the Government agency. The bond holder, to keep his original bonds, can deposit them under an escrow agreement providing for subordination with a trustee, or provide for the stamping of the subordinated bonds and coupons, or may provide for the replacement of such subordinated bonds with refunding bonds containing appropriate recitals to such subordination, and if refunding bonds are issued they may be issued without an election. In either situation mentioned here the creditor is to have a subordinated original bond or a subordinated refunding bond, *but in any event he is to have a bond.* Clearly the transaction here does not meet any of such conditions. The taxes must be subordinated also.

The second paragraph of this section deals with holders of part of the existing bonded indebtedness who are not willing to enter into a subordination agreement. This authorizes the district to make a agreement with such holders with reference to taxes therefore levied for bond purposes and uncollected, only, and provides that when collected are to be placed into a special interest and sinking fund created for the sole purpose of paying interest on and principal of the bonds held by such holder or holders. Clearly this does not contemplate the issuance of any new security, but that the holder will keep his original bonds which are payable out

of a special fund derived from delinquent taxes. While the first paragraph of the section permitted refunding bonds, this paragraph does not authorize the same, but in any event the delinquent tax fund created is "payable upon the bonds held by such holder or holders." It neither authorizes nor suggests a note or other form of indebtedness, but specifically provides the antithesis.

REPLY TO REASON B-2, PAGE 18

There are several obvious reasons why this ground is not tenable:

1. The case of Miller vs. First National Bank, 25 SW (2) 306, is not by the Supreme Court of Texas, but by an inferior Court, namely, the Fourth Court of Civil Appeals at San Antonio, opinion by Judge Fly and no petition for a writ of error was filed in the Supreme Court.

2. The case does not involve Municipal securities and is therefore not in point.

3. The petitioners neglect to quote from it at page 48 where they attempt to discuss it but instead they quote from the decision of the trial Court in this case.

4. If it were in point it would not be controlling, bcause it would be in direct conflict with the more recent case by the Supreme Court of Texas dealing the matter at hand. Brown County W. I. D. No. 1 vs. Austin Mill & Grain Company. 135 Tex. 140, 138 SW (2) 523.

It is interesting to note that the petitioners fail to cite or attempt to discuss and disinguish this most

recent case by the Supreme Caurt either in their petition or brief notwithstanding it is directly in point.

## REPLY TO QUESTION VI, PAGE 15, AND REASON F, PAGE 21

The note involved increased the indebtedness of the district regardless of the construction of the resolution of the R. F. C.

## STATEMENT

The R. F. C. resolution (R. 123) shows clearly that it was advancing $902,500.00 to or for the benefit of the district to refund or refinance its bonded and funded indebtedness outstanding, aggregating over $2,000,000.00 at 45.895 upon each dollar of principal and no payment upon interest. That when all the old securities were brought subject to the plan voluntarily or by composition proceedings, the R. F. C. would accept refunding bonds for the amount of the money actually advanced plus 4 per cent interest. That when 90 per cent of the old securities were brought subject to the plan the R. F. C. might purchase them subject to its right to keep the old securities alive until the plan was fully consumated, if it were to its interest to do so.

## ARGUMENT

Three views could be taken of this resolution, which constitutes the contract between the R. F. C. and the district, so far as the status of the old securities is concerned. Obviously the Abrahams are trying to take advantage of this contract, yet claiming they are not bound by it, notwithstanding they have

received the full amount (45.895) from the R. F. C. upon it. (R.165). The old securities held by the R. F. C. were either (1) owned by the R. F. C. outright; (2) or the bonds are held by the R. F. C. as collateral for the loan or advancement, in which event the R. F. C. is a holder in due course of the collateral; or (3) the bonds were cancelled, scaled down and extinguished and the rights of the R. F. C. were under the executory contract (R. 123-142) as provided in section 403 Title 43 U. S. C. A.

If category (1), supra, is correct then the full title is in the R. F. C. as well as being a holder in due course. In that event the Abrahams have received $14,686.40 in cash, plus a preference of $21,048.82 in a note, or a total of $35,735.22, for their $32,-000.00 in bonds and the district still owes the sum of $53,048.82 in principal plus interest.

If category (2), supra, is correct then the situation is the same in event the district defaulted in its payment to the R. F. C., and the R. F. C. took title to the collateral under foreclosure or the title passed to some other holder in due course at such foreclosure.

If category (3) supra, is the correct view then the old debt of $32,000.00 plus 6 per cent interest was automatically reduced or scaled down to $14,-686.40 plus 4 per cent of interest under the provisions of section 403 Title 43, U. S. C. A. This was the view of the trial Court (conclusion of law No. 2, R. 168) and the Circuit Court of Appeals, (R. 361 last paragraph). The only difference

between the two Courts relates to the effect of this upon the Abraham note. The trial court said he was taking a practical view of the situation treating the refinancing plan as a consumated transaction. (R. 204). The Circuit Court of Appeals treated the plan also in its ultimate state with the old securities brought subject to the plan and cancelled and the new securities for 45.895 on each dollar of principal and 4 per cent interest outstanding. Both the legal and the practical effect of this transaction was to reduce the old debt from $1.00 to 45.895 and the evidence of it from the old bonds, which would be cancelled, to the refunding bonds, which would be issued, pursuant to law, solely in lieu thereof.

This is true because both the debt and the evidence thereof would be reduced pursuant to law by an agreement between the R .F. C., the legal and equitable owner and holder of the $32,000.00 in bonds and the district that owed the full amount thereof.

This would leave the note standing solely upon the resolution of July 30, 1937, purporting to authorize it. Manifestly the note increased the indebtedness or attempted to create new indebtedness by $21,048.82 plus 4 per cent interest for two years and pledged present and future tax levies to pay the same.

The attempt to pledge future taxes is sufficient alone to make the note void.

Brown County W. I. D. No. 1 vs. Austin Mill & Grain Company; 138 SW (2) 523.

Terrell vs. Dessiant, 71 Tex. 770.

McNeal vs. City of Waco, 89 Tex. 83.

It would follow therefore, that the note and supporting resolution attempted to create an indebtedness or new debt under any probable interpretation of the R. F. C. resolution.

## REPLY TO QUESTION IV, PAGE 13 AND REASON D, PAGE 19.

### STATEMENT

The petition for confirmation was filed under Chapter IX of the Bankruptcy Act offering the R. F. C. plan on June 29, 1940, (R. 316). Order approving the petition and setting it down for hearing was entered July 1, 1940, (R. 321). The R. F. C. which owned $1,948,500.00 principal of bonds, accepted the plan which acceptance was filed with the petition, Exhibit "B" (R. 349). The schedule filed with the petition showed all bondholders except the owners of $2,500.00 had accepted the plan and the Abrahams' claim was shown Exhibit "C" (R353). Judgment was not entered in this Cause until September 25, 1940, awarding full recovery and mandamus, (R.158). The Abrahams filed a contest of the plan August 26, 1940, (R.332). The District was insolvent,(R.162).

### ARGUMENT AND AUTHORITIES

Over 98 per cent in amount of the creditors had accepted the plan. The district was insolvent.

Point A. The district had the right to file a petition in bankruptcy to consummate the paln.

Subsection (j) Sec. 403 Title 11, U. S. C. A.

American National Bank vs. City of Sanford, 112 Fed. (2) 435.

Cert. denied 311 U. S. 677, 61 Supet. at 45, 85 L. Ed. 436).

The Court does not hold that the composition is already effective but that the district had a right to file the petition and with the overwhelming majority approving the plan it was reasonable to suppose it would be approved. In which event the Abrahams have already received all they are entitled in equity. Judge Kennerly approved the plan and filed his findings and conclusions on June 27, 1942.

Point B. As a matter of law this proceeding could only continue with the approval of the bankruptcy court.

Subsection (c) Section 403, Title 11, U. S. C. A.

The consideration of the effect of the bankruptcy proceeding with reference to this suit will avoid a separate appeal in that case with reference to the Abrahams' claim.

## REPLY TO QUESTION V, PAGE 14, AND REASON E, PAGE 20.

It is asserted that to disallow the preference sought to be obtained by the Abrahams over the other creditors, over and above the market value of their bonds, of $24,118.43 and 6 per cent from September 25, 1940, on the note, and mandamas,

as allowed by the trial Court (R. 158) or in the alternative for $29,982.63 plus 6 per cent interest from August 5, 1937, and mandamus, upon the so-called equitable theory as found by the trial court in the alternative, (Conclusion No. 9, R. 170) would permit the district to take advantage of its own wrong.

Again the Abrahams' are reminded that this bill in equity, to cancel this void note and enjoin the district from levying or collectng taxes on their lands to pay the same, was filed and appealed by these taxpayers. If anyone was defrauded in this note transaction, it was these taxpayers, and the R. F. C., which was trying in good faith to help them. The fraud, if any, of the former directors of the district, or of the Abrahams' could not be imputed to these taxpayers.

It is a well settled rule of law in Texas that the fraud, or conspiracy of the officials of a municipality, cannot be imputed to the municipality and do not estop the municipality. Parker vs. State of Texas, 68 SW (2) 637, Points 1-4 at page 638-639, error refused. Kopecky vs City of Yakum 35 SW (2) 492, affirmed 52 SW (2) 240, City of Hattesville vs. Long 32 SW 567, approved by the Supreme Court in the above cases. The doctrine of those cases is that such officials act as strangers and their acts are ultra vires and persons dealing with them are charged with their lack of authority.

The note in this case was issued without a vote of the people in direct violation of Section 59, Article 16 of the Constitution of Texas and was therefore void. The Abrahams were charged with notice of this lack of authority. To allow the Abrahams to recover against the district upon some other theory would permit them to abrogate the Constitution of Texas above cited, the source of all authority of the district. It would permit them to do indirectly what they cannot do directly. It is well settled that the district can take advantage of this lack of constitutional power, Cameron County Water Improvement District No. 8 vs. De La Vergne Engnie Company, 93 Fed. (2) 373.

There is still another reason why the Abrahams cannot recover upon any theory in this case. This proposition was presented in our brief in the Circut Court of Appeals under Point VIII, at page 84 and the argument and authorities at pages 100 to 110, which is hereby referred to and adopted. This point is:

> "The note constitutes a preference and a transaction in violation of the spirit and the purpose of Section 616 (a) Title 15; and Section 403 (3), Title 43 of the U.S.C.A."

## STATEMENT

The Abrahams knew that the district had a loan authorized from the R.F.C., and that they were getting the exact amount of cash upon their securities that the district would get from the R.F.C.

upon the bonds. (Testimony of Lewis Abraham R. Page 284 to 291.) The Abrahams knew that the district had no other source than the R.F.C. from which the money could be obtained to pay the 45.895 upon their bonds. (Testimony of Manager Joe Burns, R.292) and finding of the trial Court (R.135). The Abrahams obtained an agreement from the district providing for a preference of $21,048.82 in the form of a note due in two years bearing 4 per cent upon their $32,000.00 par value in bonds payable out of taxes levied and to be leived in the future to pay the district's bonds (See resolution R.84-89). Section 403, title 43, U.S.C.A. and the resolution of the R.F.C. (Exhabit "A" R. 123-142,) provided that the district could not issue any other securities during the term of the loan, which were a lien upon the real property, assessments, taxes and charges imposed by the district under the State law without the approval of the R.F.C. The petitoners knew that R.F.C. had expressly refused to give consent to any preference to the Abrahams in connection with this transaction and that the R.F.C. had decided to await the effective date of the new bankruptcy law (Exhibit, 5, R. 301). The trial court found that the R.F.C. did not know of the arrangement between the district and the R.F.C., or of the execution of this note. (R.166). The Circuit Court of Appeals found:

> "Evidence in the record compels the conclusion that the Trustees were fully informed of the provisions of the agreement between the

District and the R.F.C for the loan and knew that the District had no other source from which to pay the cash amount of the settlement except by borrowing the money from the R.F.C., which required the deposit of the original bonds."

## AUTHORITIES AND ARGUMENT

Section 403, title 43 U.S.C.A. provides in part: "Such loans shall be subject to the same terms and conditions as loans made under section 605 of title 15; except that (1) the term of any such loan shall not exceed forty years; (2) each such loan shall be secured by bonds, notes, or other obligations *which are a lien on the real property within the project or on the assessments, taxes, or other charges* imposed by the borrower pursuant to State law, or by such other collateral as may be acceptable to the Corporation: (3) *the borrower shall agree not to issue during the term of the loan any other bonds so secured except with the consent of the Corporation.*" (*Italics Ours*).

Section 616 (a) Title 15, U.S.C.A. provides: "Whoever makes any statement knowing it to be false, or whoever willfully overvalues any security, for the purpose of obtaining for himself or for any applicant any loan, or extension thereof by renewal, deferment of action, or otherwise, or the acceptance, release, or substi-

tution of security therefor, or for the purpose or influencing in any way the action of the corporation, or for the purpose of obtaining money, property, or anything of value, under this chapter, shall be punished by a fine of not more than $5,000 or by imprisonment for not more than two years."

In the case of Kroll et al. vs. Scott 155 SW (2) 985 at 988 (4), (5), writ of error refused by the Supreme Court of Texas, it was held that a contract of an attorney with a district for legal services in the preparation, presentation and prosecution of an application for a loan from the R.F.C. upon a contingent basis was void because the R.F.C. had a regulation prohibiting such transaction upon a contingent basis. Such trasactions violated Section 616 (a) of Title 15, U.S.C.A.

It is submitted that case is directly in point. It involved the violation of a regulation promulgated by the R.F.C., while the contract in the case at Bar violated the resolution of the R.F.C., and Section 403 Title 43, U.S.C.A., of which the Abrahams had both actual and constructive knowledge.

The Supreme Court of Texas, as well as other Courts of the Nation, have made similar holdings under similar facts and similar statutes involving persons obtaining preference in connection with loans from other governmental agencies, namely: the Federal Land Bank and the Home Owners Loan Corporation.

McCroy vs. Smeltzer 124 SW (2) 336 (1)
Comm. of Appeals.
Briley vs. Oldham 124 SW (2) 854 (1)
Comm. of Appeals.
O'neal vs. Johnson 29 Fed. Sup. 307.
Pye vs. Grunert 276 NW 221, 201 Minn. 191.
We have decided to quote syllabi 4 and 5 from Kroll et al. vs. Scott 155 SW (2) 985:

"4 CONTRACTS 123 (1)

Under rules of Reconstruction Finance Corporation and applicable federal law, the making of agreement regarding fees for legal services rendered in making application for loan from the corporation, contingent upon the obtaining of the loan, was prohibited. Reconstruction Finance Corporation Act, 16 (a), 15 U.S.C.A. **616(a).

5. CONTRACTS 123 (1)

An alleged agreement regarding fees for legal services rendered in application for loan from the Reconstruction Finance Corporation, under which the services would be paid for only if the loan was granted, was against "public policy" and was void. Reconstruction Finance Corporation Act, 616 (a), 15 U.S.C.A. **616 (a)".

It is manifest from the above authority that this contract made in violation of the above statutes is against public policy and void. The Abrahams prate about the wrongs of the former officials of

the district to which they were a willing party and seek equitable relief thereon when they do not come into court with clean hands.

WHEREFORE, PREMISES CONSIDERED, these taxpayers pray that the writ of certiorari be denied and that in any event the decision of the Circuit Court of Appeals be affirmed in order that justice may be done.

Respectuflly submitted,
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Hidalgo County Water Control & Improvement District No. 1, of Edinburg, Texas, one of the respondents herein adopts the above and foregoing reply to the petition for writ of certiorari.

Respectfully submitted,
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